THE STATE JOURNAL COMPANY
Printers to the Commonwealth
Frankfort, Kentucky

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Office Supreme Court,
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Supreme Court of the United States

OCTOBER TERM, 1934

The Stewart Dry Goods Company, . . . Appellant,
vs. No. 454
John B. Lewis, et al., ... Appellees.
Fred Levy, et al., ... Appellants,
vs. No. 455
John B. Lewis, et al., ... Appellees.
J. C. Penney Company, ... Appellant,
vs. No. 456
John B. Lewis, et al., ... Appellees.
Kroger Grocery & Baking Company, . . . Appellant,
vs. No. 457
John B. Lewis, et al., ... Appellees.

PETITION FOR REHEARING

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Postal Telegraph Cable Co. vs. Adams, 155 U. S. 688, 698.

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Supreme Court of the United States

OCTOBER TERM, 1934

THE STEWART DRY GOODS COMPANY	*Appellant*
vs.	
JOHN B. LEWIS, ET AL.	*Appellees*
FRED LEVY, ET AL.	*Appellants*
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J. C. PENNEY COMPANY	*Appellant*
vs.	
JOHN B. LEWIS, ET AL.	*Appellees*
KROGER GROCERY & BAKING COMPANY	*Appellant*
vs.	
JOHN B. LEWIS, ET AL.	*Appellees*

PETITION FOR REHEARING

May It Please the Court:

The above styled appeals are now pending on petitions for a rehearing.

In the opinion of the court, delivered by Mr. Justice Roberts, it is said:

> "In several recent cases we sustained a classification of chain stores for taxation at rates higher than

those applicable to single stores graduated upward on each store as the total number of units in one ownership increased. We found this classification reasonable because of advantages incident to the conduct of multiple stores and obvious differences in chain methods of merchandising as contrasted with those practiced in the operation of one store."

There are appended in the footnotes the cases from this court supporting this proposition. We submit that the same considerations which support the classification of chain stores for taxation at rates higher than those applicable to single stores support with equal force a classification of department stores different from stores that deal in a single line of goods or a few lines of goods of coordinate character.

As pointed out in the case of Moore vs. the State Board of Charities and Corrections, 239 Ky. 729, 40 S. W. (2d) 349, that, while it is true in the case of department stores that each department is in competition with small independent dealers, dealing in one line of goods or a few coordinate lines and who will not have to pay this sales tax whereas the department sales because of being added to sales of other departments will have to bear its proportion of the gross sales tax, thus putting such department at a disadvantage in its competition with the independent dealer, yet the proof in that and in the above styled appeals discloses that the advantages which a department has in the location of the store of which it is a department, its sharing with the other departments of overhead, of purchasing power, of obtaining discounts for cash, of advertising, of window display, of unified and superior management, all or most of which the average specialty store does not enjoy, supports the department store classification.

Indeed, we take it that the opinion of Mr. Justice Roberts for the court, at least by inference, sustains this contention for he therein differentiates between those who

sell but one sort of goods and those who, through departments, deal in many lines of merchandise.

In this opinion the proposition, supported by abundant authority in the footnotes, is laid down that, in resolving this issue of taxation, the courts are not concluded "by the name or description of the tax as found in the act." "The duty of the court is to ascertain its nature and effect." To use the quotation in the opinion from the case of Postal Telegraph Cable Company vs. Adams, 155 U. S. 688, 698—

> "The substance and not the shadow determines the validity of the exercise of the power."

In other words, the court in determining the validity of a taxing statute will look at the realities of the situation and to this end we invite the attention of the court.

Your Honors will take judicial notice of the geography, the population, the character of its economic life, and the concentration of population of the state of Kentucky and its people. It contains approximately 40,000 square miles. Its population is slightly in the rise of 2,500,000. Its economic support is mainly agrarian in character, with the coal mining industry being of some moment in Eastern and Southeastern Kentucky, coupled with a lesser development of oil and gas. Save in the larger cities of Ashland, Louisville, Paducah, Covington, Newport and Lexington, the manufacturing industry is not large. There is but one city of the first class in the State. Under the Constitution, Section 156, cities with a population of 100,000 are cities of the first class. The one city of the first class is Louisville, with a population, including that of the surrounding county in which it is located, of perhaps 350,000. There are no large cities or centers of population across the Ohio River from Louisville. Ashland, Paducah, Lexington, Covington and Newport are cities of the second class which include cities from 20,000 to 100,000 in population. None of them, except

Covington and Newport, have near them any large center of population or hinter-land of which there is a density of population. Covington and Newport are opposite the city of Cincinnati but, as we shall point out, this very fact, instead of affording a clientele for its stores and merchants, works quite to the contrary and is a drain upon the Kentucky clientele which the merchants of Covington and Newport might look to for their customers, the latter preferring the larger stores and perhaps greater variety of merchandise to be found in the larger metropolis than in the smaller cities of Covington and Newport. The other cities of Kentucky range from 20,000 and less in population down to a negligible number. The census statistics of the counties (there being 120 of them in Kentucky) disclose no great density of population anywhere, with the possible exception of the city of Louisville, and even there the population is as above stated. The census figures of which this court takes judicial notice disclose a per capita worth of $.

The court knows that any community that depends so much in the main for its income on agrarian activities will not be one where the purchasing power of the community can rise to very great heights.

With these observations in mind, we submit that although, as the court says in its opinion, on its face the tax does not seem to be confined to those who do business by the chain store method or by the department store method, yet looking through the shadow to the substance, as this court says we must in this very opinion, the tax cannot in reality operate and will not operate except on merchants who do business by the methods which this court says supports the classification.

With the markets available to them, with the clientele upon which they can draw, we confidently assert that this record, together with the facts which the court judicially knows, discloses that no merchant dealing in but one line of

goods or in a few coordinate lines of goods by retail in the state of Kentucky will ever rise to the dignity of a gross sales of $400,000.00 per year.

There is no party complaining of this tax before the court except those doing business either on the chain store method or the department store method. The reason for this lies in the very fact we are trying to emphasize, and that is whatever name the tax bore, it was in truth and in fact a tax on chain stores and department stores, and not one on the individual merchant dealing in a specialty line or in a few coordinate lines of business. The legislature knew that such merchants doing business in such individual lines would never have sales amounting to as much as $400,000 per year by retail. The political economy in the State forbade any such result.

For the same reasons that have actuated the chain store legislation throughout the Union, the legislature was passing this gross sale stax because of the unfavorable decision of the Indiana tax then rendered by the lower courts. The legislature, prior to the reversal of the decision in the Indiana case, sought to achieve the same results by the act here in question. They knew the act which they were passing would never apply to anybody but chain stores and department stores, but framed it as they did in order to avoid the criticism aimed at chain store legislation in the decision in the lower court on the Indiana tax.

We submit, therefore, that this act, though not called such, is in truth and in fact a tax on doing business by the chain store method or by the department store method. As a matter of fact, the act has been repealed, but assuming its continued vitality and assuming that in the course of time the economic life of Kentucky would so change as that the act would become broader in its scope than it would ever reasonably be anticipated to have, would it not then be the time and the place to raise its constitutionality by one who did not labor under the classification of a chain store or department store operator?

For we take it that it is axiomatic that one who is not hurt or has no grounds to complain of the constitutionality of the act will not be heard to question such constitutionality. Surely the parties to this suit, department stores and chain stores, whose activities, as this court points out, affords a basis for classification, ought not to be heard to say that in some remote time, had the act remained on the statute books, the political economy of the State might have become so large as to embrace those merchants who, this court says, would have a just cause of complaint if they were doing business in one line of goods or a few coordinate lines. If realities are to control and this is a chain store or department store classification, it is valid as this court in the opinion concedes.

We also wish the court to reconsider the proposition advanced in the opinion of the majority that no difference is suggested, so far as concerns the transaction, which is the occasion of the tax, between the taxpayer's first sale of the year and his thousandth; and that the statute is unjustifiably unequal, whimsical and arbitrary as much so as would be a tax on tangible personal property—say cattle stepped up in rate on each additional animal owned by the taxpayer, or a tax on land similarly graduated according to the number of parcels owned.

We regret that our argument and brief did not make more manifest to the court our position which we think is abundantly supported by the record that there is a decided difference between the first and even the hundredth or even the second sale in any store. Until the second sale is made, the first sale bears all of the burden of the overhead, the rent, the light, the heat, the advertising, the clerk's hire, the general office expense. As soon as the second sale is made the burden begins to be pro-rated and diminishes per sale until the point is reached where some additional expense must be incurred because of the increased volume of business. But even here the added expense, when pro-rated out over all of the transactions, is less per unit of sale

than was the burden on the first sale where the overhead was not so large. Indeed we would not need a record to support so obvious a principle of political economy and merchandising.

May we invite the attention of the court to what we said in our brief on the original hearing in this case relative to this point?

"We submit that appellants have failed to offer any legitimate proof to rebut the legislative presumption supporting the classification in the challenged act. Appellees' contention that the classification is reasonable may be sustained upon the following grounds:

(d) Increased volume of sales results in increased profits.

(e) Large scale merchandising firms, such as appellants, pay relatively less tax for state and local purposes than do their small competitors.

(f) Large scale merchandising firms have an advantage over their small competitors in standardization of equipment and display, superiority and uniformity in store management, rapid turnover and unified sales policy.

(d) Relation of Sales to Profits

The appellees take the position that the classification made by the challenged act may be sustained alone upon the ground that increased volume of sales results in increased profits. We sustained this proposition by the evidence of economists and by actual operating statistics of merchandising firms. Appellants, of course, disagree with this proposition and contend there was no relation between increased sales and profits. They present nothing to sustain their contention and, as we will later point out, in fact sustain appellees.

Judge Dawson, writing the opinion for the Court, in discussing this controversy and as to whether or not it presented a reasonable foundation for the classification, used this language:

> "There is a widely accepted theory of economics that, as a general proposition, ability to pay increases with volume of business, because, generally speaking, increased volume of business means increased profits. We recognize, of course, that this theory of economics is not universally accepted, but, on the contrary, is vigorously opposed by another school of economic thought. These opposing theories were vigorously advanced in these cases by businses men and economists in their testimony. If economists and business men disagree on these propositions, how can it be said that legislative classification in harmony with one of these schools of thought to the exclusion of the other is not reasonably founded in the 'purposes and policies of taxation,' or that such classifications precludes the assumption that it was in good faith exercise of legislative judgment and discretions?"
>
> (Kroker R. pp. 113-114.)

Professor Martin presented exhibits I to VII to sustain his evidence. (Kroger R. pp. 491-494.) These exhibits deal with different classes of retailing establishments. Exhibit I shows that stores having sales of less than five hundred thousand dollars earn profits of 2.8%; stores with sales ranging from five hundred thousand to two million dollars earn 3%, and stores having sales in excess of two million dollars earn an average profit of 5.2%. Professor Martin in analyzing Exhibits II, III, IV and V, said:

> "Exhibit II sets forth similar data for a large number of department stores scattered over the United States, including several in Kentucky. In each year the experience of department stores confirms that of the specialty already discussed in that earnings on sales were very much higher for large-scale en-

terprises than for the smaller-scale operators. In 1929, for instance, the retailers having sales of between $150,000 and $299,000 made an average of 2 per cent on sales, whereas those selling $10,000,000 or more during the year made an average of 5.3 per cent. The showing for the years 1928 and 1927 is even more conclusive (for department stores) than for the abnormal year 1929.

"Another and more significant analysis of the reliability of the theory that large-scale operation makes possible certain economies unattainable for those who operate on a small scale is offered in a series of exhibits now being presented, showing the ratios of profits or net gain (by which we mean return on invested, borrowed as well as owned capital) to invested capital as shown by net worth, in certain types of retailing by size groups.

"Exhibit III shows the ratio of net profits to net worth of retail jewelry stores for the year 1927, the only year for which information is available. The exhibit indicates that the least efficient jewelers, speaking in terms of size-groups, are those having sales of between $20,000 and $49,000 each. On the average these incurred a loss of 0.7 per cent. The return ranges from this negative quantity on small stores to a positive 3.2 per cent on stores having $500,000 or over of sales. This exhibit may be accepted as a typical example of one of the less efficient retailing groups. It indicates that in no instance is the net return based on the investment of owners particularly generous. It approaches adequacy only in the case of those having net sales of $500,000 or over.

"Exhibit IV shows the relation between net gain and the capital investment, as measured by net worth, of retail specialty stores scattered over the United States. (This is the same group of stores used in exhibit I.) Analysis of this exhibit shows that large retailers in the specialty field appear to derive very much greater gains if they are large-scale operators than if they do business on a small scale or relatively small scale.

"Exhibit V shows the ratio of net gain to net worth of department stores, both chain and independent, for the three years ending 1929. In 1927 and 1928 it will be observed that, as the size of the business increases, there is an almost perfectly continuous tendency toward an increase of the rate of net gain to net worth. Even in the abnormal year 1929 this tendency, while not absolutely continuous, is certainly unmistakable.

"Summarizing these evidences, it may be said that the effectiveness of the merchant, as measured either in terms of ratio of net income or net gain to sales or of the ratio of net income or net gain to capital invested by owners, is greater in large than in small enterprises. The evidence all points to the conclusion that large-scale are more profitable than small-scale enterprises. This conclusion would imply, on the basis of generally accepted principles of justice in taxation, that it is justifiable to tax the large-scale operator at a higher rate than the dealer engaged in retailing on a small scale."

(Kroger R. pp. 482-483.)

Appellants sought to belittle and destroy the effect of Dr. Martin's evidence, together with the operating statistics submitted by him, by introducing Harry W. Schacter, President of the Kaufman-Straus Company, one of the intervenors. His attention was called to the affidavits of Professors Walradt, Martin and Phelps, showing the relation of profits to sales and the return on invested capital, to which he replied:

"That might be correct theoretically but all the supporting facts and figures from actual experience of department stores indicated that there was no relationship."

(Kroger R. p. 437.)

This witness in discussing his theory of economics, apparently evolved by himself and wholly unsupported by any

other evidence, undertakes to sustain his statement that there is no relationship between profits and increased sales by a discussion of what he calls the "interquartile range." The witness, however, contradicts his statement just quoted that there was no relationship between increased sales and profits in discussing Dr. Martin's Exhibit No. I, when he makes this statement:

> "Professor Martin again quotes average figures and leaves out the interquartile ranges quoted in this table. For example, the increase in percentage of net worth of stores doing less than a million is 8.9%, whereas in stores doing over a million dollars in sales the increase in net worth is 15.5%"
>
> (Kroger R. p. 441.)

Here the witness admits that table 34, page 45, of Bulletin 78 of the Bureau of Research of Harvard University shows the average increase in percentage of net worth of merchants having sales of less than one million dollars is 8.9%, whereas in stores having over a million dollars in sales the increase of net worth is 15.5%. The witness then proceeds to discuss the interquartile range by showing that stores having sales of less than one million dollars had a range of profit of from 3.20% to 20.75% and stores having more than one million dollars in sales have an interquartile range of from 10.64% to 20.35%. We submit that this admission on the part of the witness sustains our theory. He overlooks the fact that while some stores in the less than million dollar class had an increased percentage of net worth of 20.75%, the average of this class is 8.90%; and likewise overlooks the fact that the lowest percentage of stores with sales in excess of one million dollars is 10.64%, while the lowest in the first class earns only 3.20%.

The majority opinion of the lower court points out very clearly and correctly that the Legislature in levying a tax is not required to make inquiry as to whether the

taxing statute will impose a tax upon some business that is making little or no profit. We quote from the opinion:

> "The test is, what is its effect generally upon the class taxed or what is the effect generally upon any branch or subdivision of that class."
>
> (Kroger R. p. 117.)

To further illustrate the fallacy of the appellant's contention that there is no relation between increased sales and profits, we quote from the evidence of the witness Schacter with reference to Martin Exhibits IV and V:

> "Attention of the witness was then called to Martin Exhibits 4 and 5 and to page 8 of Bulletin 83 of the Bureau of Business Research of Harvard University on the operating results of department stores in 1929. His attention was also called to pages 20 and 28 of the same bulletin. The witness thereupon testified that the percentage of gain to net worth, according to Professor Martin's figures indicated that he again used the average figures all the way down the line and omitted the interquartile ranges. For stores doing less than $500,000 Martin showed a percentage of gain to net worth of 5.7%. For stores doing $500,000 to $2,000,000 of business he showed a percentage of gain to net worth of 7.5% and for stores having sales in excess of $2,000,000 he showed a percentage of gain to net worth of 8.5%.'
>
> (Kroger R. p. 442.)

The witness here admits that the figures used by Professor Martin show he used average figures. The witness does not challenge the correctness of the percentages of gain to net worth shown by Exhibits IV and V, but again reverts to his interquartile range argument, showing that some merchants having sales of less than $500,000 had a larger percentage of net gain than merchants having sales in excess of $2,000,000.

The figures in the exhibits which we have discussed related to the years 1927, 1928 and 1929. Professor Martin in giving his deposition on the final hearing supplemented the information shown in Exhibits I to V, which we have discussed, by Exhibits I-A, II-A, II-B, IV-A and V-A. (Kroger R. pp. 531-533.) Professor Martin, to show the correctness of the statement contained in his original affidavit, which we have discussed and which was criticized by Mr. Schacter by injecting his interquartile range theory, presented Exhibit XIX (Kroger R. p. 528B) putting the testimony of Mr. Schacter in graphic form. In discussing this exhibit the witness said:

> "The witness was thereupon asked the significance of Exhibit 19 and replied that in his affidavit filed in 1931 the data given in the line marked 'Average' were incorporated as part of the affidavit. The evidence presented by Mr. Schacter made a good deal of comment on the fact that there was omitted from the witness's original testimony the data respecting the interquartile range. Witness thought it would be convenient for the court to put the tesimony of Mr. Schacter in graphic form. The exhibit means, the witness stated, that the average percentage, that is, the average net gain as a percentage of net worth is indicated in the middle line. The solid line in the chart and the middle fifty per cent of the cases arrayed according to the rate of earnings on net worth are shown between the dotted lines, the middle fifty per cent being the interquartile range that Mr. Schacter referred to. This graph showed, the witness stated, that the middle fifty per cent of the cases arrayed with respect to earnings of the department stores moved very much as the average moved. In other words, the earnings on the invested capital in the case of the smaller enterprises is relatively lower and that on enterprises of intermediate size considerably higher, and that on enterprises of very large size in the department store business it is even larger than the earnings on the intermediate class. The witness stated that it did not seem worthwhile to prepare an exhibit to show the earnings

> on net sales but from his general investigation it would be about the same in general character. The witness also stated that in preparing his chart he did not use the data used by Mr. Schacter but he drew it from the original source."
>
> (Kroger R. pp. 508-509.)

The witness filed with his deposition exhibits XVII to XXXI (Kroger R. pp. 525-542A), in which he demonstrates by charts, graphs and tables the correctness of his evidence that increased sales result in increased profits. His evidence explaining these various exhibits is found on pages 508 to 521, Kroger Record. The evidence presented here shows conclusively there is no basis for the oft-repeated assertion in appellants' brief that the classification in the challenged act was discriminatorily and arbitrarily made; it establishes conclusively that the classification was a "good faith exercise of legislative judgment and discretion."

The lower Court under findings of fact relative to the Fourteenth Amendment, No. 10, recognized that appellees had sustained their claim that increased volume of sales results in increased profits and increased ability to pay taxes. Finding No. 10 follows:

> "10. The evidence fails to show that there is no relation between sales volume and net earnings, nor does it satisfactorily rebut a widely accepted theory of economists that, as a general proposition, increased volume of sales results in increased profits and increased ability to pay. On the contrary, there is substantial evidence supporting the affirmative of each of these propositions."
>
> (Kroger R. p. 147.)"

After all, this tax, graduated as it is, is a burden upon the entire business done by the merchant. The income

from the business must pay the tax in the last analysis and, although the tax is measured and graduated according to the volume and sales yet, when the tax is finally computed, it rests upon the business generally. To use the illustration advanced by the court in its majority opinion, individual acres of coal land may in and of themselves be of little worth and yet when brought together in one big operation, and because of their connection one with another, the total acreage may become quite valuable. If we look at realities instead of shadows, the tax here involved is a tax on the total business done, measured and stepped up because of the increased business done because of the volume. The reasonableness of the tax, we take it, is measured by incidents of its general operation and not by what may happen in some sporadic case or incident. As pointed out above, the general operation of this tax is on those whose profits increase because of the increase in business done and whose contributions to support of government by way of taxation decline because of the method of doing business along the chain store or departmental line.

Just as it is fair to lay a tax on a thousand acres of coal land higher because of these thousand acres being brought together and thus the operation being rendered more valuable than could be levied on an isolated acre of coal land which would be valueless, so it is right to levy a higher gross sales tax where the business is larger than where there is a small amount of business done.

We therefore respectfully submit in the inverse order of this argument that the record does disclose a decided difference between the first and the thousandth sale that justifies and supports this graduated tax. If we look through the shadow to the substance, we find that this tax is in truth, no matter what it may be called, actually a chain store and department store classification and, being such, is a reasonable one under the authorities and as this court

concedes. If this be true, we respectfully submit that the petition for rehearing should be granted and the judgment herein affirmed.

Respectfully submitted,

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I, S. H. Brown, assistant attorney general of Kentucky, counsel for appellees, do certify that the above petition for rehearing is filed in good faith and not for delay. I further certify that counsel for appellants have been furnished copies of said petition.

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Assistant Attorney General.